

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE  
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 99-30466

CARIBBEAN CIGAR COMPANY  
d/b/a CARIBBEAN CIGAR & TOBACCO CO.  
d/b/a CARIBBEAN CIGAR COMPANY, INC.  
d/b/a CARIBBEAN CIGAR FACTORY  
d/b/a CARIBBEAN CIGAR HOLDING CORP.

Debtor

ANN MOSTOLLER, TRUSTEE

Plaintiff

v.

Adv. Proc. No. 01-3021

EDWARD WILLIAMS

Defendant

**MEMORANDUM ON DEFENDANT'S  
MOTION FOR SUMMARY JUDGMENT**

APPEARANCES: MOSTOLLER, STULBERG & WHITFIELD  
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**RICHARD STAIR, JR.**  
**UNITED STATES BANKRUPTCY JUDGE**

By her Complaint to Avoid Preferential Transfer and Fraudulent Conveyance (Complaint) filed on February 1, 2001, Ann Mostoller, Trustee (Trustee), sought to avoid \$148,538.77<sup>1</sup> in transfers from the Debtor to the Defendant. The Trustee looked to avoid the transfers either as preferential under 11 U.S.C.A. § 547(b) (West 1993) or as fraudulent under 11 U.S.C.A. § 548(a) (West 1993).

The Defendant, who was an officer of the Debtor and thus an insider pursuant to 11 U.S.C.A. § 101(31)(B)(ii) (West 1993), filed a Motion for Summary Judgment on November 30, 2001. In response, the Trustee withdrew her fraudulent conveyance action and reduced the amount of her preferential transfer claim to \$48,335.00.<sup>2</sup> As a result, the sole remaining issue before the court is whether unpaid salary owed to the Defendant may be applied as an offset under the subsequent value defense of 11 U.S.C.A. § 547(c)(4) (West 1993).

Each party has filed a brief in support of its position. Also before the court is the Defendant's Affidavit of Edward Williams filed with the Motion for Summary Judgment.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(F) (West 1993).

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<sup>1</sup> This sum reflected payments made to the Defendant within the year preceding the Debtor's bankruptcy filing. These payments subtotaed \$33,484.08 in salary, \$20,920.06 in reimbursement of expenses, and \$94,134.63 in loan repayments.

<sup>2</sup> The Trustee no longer disputes the salary payments or the reimbursement of expenses. The \$48,335.00 amount reflects the loan repayments minus the sum of three additional loans made by the Defendant to the Debtor within the year leading up to the bankruptcy filing.

## I

The parties are in agreement as to all relevant material facts.<sup>3</sup> The Debtor filed its Voluntary Chapter 7 Petition on February 8, 1999. Prior to April 1998, the Defendant loaned \$70,000.00 to the Debtor. Within the year preceding its bankruptcy filing, the Debtor repaid that loan with interest.<sup>4</sup>

From August 1, 1998, through February 5, 1999, the Defendant continued to work for, but received no salary from, the Debtor. His unpaid earnings totaled \$47,692.38.

What follows is a breakdown of the financial exchanges remaining at issue. Between April 7, 1998 (the date of the \$74,134.63 loan repayment), and October 20, 1998 (the day before the Debtor's next loan repayment), the Defendant made \$65,800.00 in additional loans to the Debtor and provided \$21,923.11 in unpaid labor. On October 21, 1998, the Defendant received a second loan repayment, in the amount of \$10,000.00, from the Debtor. Between that date and January 24, 1999 (the day before the Debtor's final loan repayment), the Defendant provided an additional \$25,769.27 in uncompensated labor. On January 25, 1999, the Debtor made a final loan repayment of \$10,000.00 to the Defendant. Between that date and the Debtor's bankruptcy filing, the Defendant's subsequent unpaid labor totaled \$3,461.54.

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<sup>3</sup> Pursuant to FED. R. CIV. P. 56, made applicable to this adversary proceeding by FED. R. BANKR. P. 7056, summary judgment shall be granted if "there is no genuine issue as to any material fact and [ ] the moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c).

<sup>4</sup> The payment was made on April 7, 1998, in the amount of \$74,134.63.

## II

The Defendant does not dispute that the \$94,134.63 in loan repayments made to him in the year prior to the Debtor's bankruptcy were preferential transfers under § 547(b).<sup>5</sup> However, he argues that because of the uncompensated labor and additional loans he provided to the Debtor, the subsequent value defense of § 547(c)(4)<sup>6</sup> prevents the Trustee from avoiding the majority of

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<sup>5</sup> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C.A. § 547(b) (West 1993).

<sup>6</sup> (c) The trustee may not avoid under this section a transfer—

. . . .

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor[.]

(continued...)

the loan repayments.<sup>7</sup> The Trustee agrees that the loans made by the Defendant between June 9 and June 22, 1998,<sup>8</sup> should be applied as new value to offset the preferential transfers but contends, without citation to any supporting authority,<sup>9</sup> that to allow the Defendant's unpaid salary as a new value offset would "fl[y] in the face of the intent of the law" and would be "particularly egregious."

The subsequent value, or new value, provision of § 547(c)(4) is "an exception to the general rule that preferential transfers may be recovered for those situations in which a creditor provides new value after the preferential transfer is made but before the filing of the Debtor's bankruptcy petition." *Fitzpatrick v. Rockwood Water, Wastewater & Natural Gas Sys. (In re Tennessee Valley Steel Corp.)*, 201 B.R. 927, 939 (Bankr. E.D. Tenn. 1996). "New value" is defined by the Bankruptcy Code in relevant part as "money or money's worth in goods [or] services[.]" 11 U.S.C.A. § 547(a)(2) (West 1993). The new value must have been extended by

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<sup>6</sup>(...continued)  
11 U.S.C.A. § 547(c)(4) (West 1993).

<sup>7</sup> The Defendant concedes that the final \$10,000.00 loan repayment dated January 25, 1999, was followed by no more than \$3,461.54 in subsequent value. The Defendant acknowledges, therefore, that the difference - \$6,538.46 - is avoidable by the Trustee.

<sup>8</sup> For reasons not clear to the court, neither party discusses § 547(c)(4)'s application to the Defendant's October 7, 1998 \$20,000.00 loan to the Debtor.

<sup>9</sup> The Trustee only cites *Burner Servs. & Combustion Controls Co., Inc. v. Pipefitters Union Local No. 455 (In re Burner Servs. & Combustion Controls Co., Inc.)*, No. 4-87-1104, Adv. No. 4-89-86, 1989 WL 126487, at \*3 (Bankr. D. Minn. Oct. 25, 1989), which, through dicta, might arguably stand for the proposition that the labor of non-insider employees can constitute new value under § 547(c)(4). The Trustee did not, however, provide the court with a copy of that unpublished opinion. The Trustee is reminded that pursuant to Rule 7.4 of the Local Rules of the United States District Court for the Eastern District of Tennessee, "Citations to any federal court decision . . . not fully reported in one of the publications of the West Publishing Company . . . shall be accompanied by a copy of the entire text of the decision. . . . The court will NOT consider improperly cited authority." E.D.TN. LR 7.4. Although the Local Rules of the United States Bankruptcy Court for the Eastern District of Tennessee do not have a corresponding local rule, the court will adhere to the district court rule.

the creditor after the preferential transfer but before the filing of the bankruptcy petition. See *Tennessee Valley Steel*, 201 B.R. at 940.

The subsequent value may be netted against all prior preferential transfers as opposed to the immediately preceding transfer only. See *id.* However, any excess new value remaining after such netting may not be used to offset subsequent transfers. See *id.*

The few courts to consider the issue at bar have each held that services performed by an employee constitute new value, even where the employee is an insider. See *Bash v. Schwartz (In re B. Schwartz Furniture Co., Inc.)*, 131 B.R. 623, 626 (Bankr. N.D. Ohio 1991) (officers of debtor); see also *Apache Coal Co., Inc. v. U.M.W.A. (In re Apache Coal Co., Inc.)*, 68 B.R. 314, 315 (Bankr. W.D. Va. 1986) (non-insiders); *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 56 B.R. 339, 393 (Bankr. D. Minn. 1985) (same). This court agrees.

The purpose of § 547(c)(4) is to facilitate rehabilitation by encouraging creditors to continue dealing with troubled businesses. See *Tennessee Valley Steel*, 201 B.R. at 939. The subsequent value exception encourages employees, as well as suppliers, to continue their relationship with the Debtor. See *Bellanca*, 56 B.R. at 393.

In the present case, there is no indication of fraud or bad faith by either the Defendant or the Debtor in their dealings with one another. In fact, the Trustee acknowledges that “the Defendant’s services to the Debtor during the preference period were of value to the Debtor.” In

the absence of fraud or bad faith, the court sees no reason to treat the Defendant differently based solely on his status as an insider.

Further, there are no facts that would trigger the provisions of § 547(c)(4)(A) or (B) to defeat the new value provided by the Defendant. For example, there is no suggestion that the Debtor's October 21, 1998, or January 25, 1999 loan repayments were "otherwise unavoidable" transfers on account of the new value. See 11 U.S.C.A. § 547(c)(4)(B); *Tennessee Valley Steel*, 201 B.R. at 940-41. While the payments were doubtless "on account of" the prior loans, no other subsection of § 547(c) appears applicable to prevent the use of those loans as new value. See *Tennessee Valley Steel*, 201 B.R. at 940-41.

For the reasons outlined above, the Defendant's Motion for Summary Judgment will be granted. The Trustee is entitled to a judgment avoiding and recovering only \$6,538.46 of the preferential transfers made to the Defendant. Under § 547(c)(4), the loans and uncompensated services provided by the Defendant between April 7, 1998, and January 24, 1999, are sufficient new value to defeat the Trustee's avoidance of the April 7 and October 21, 1998 preferences. The \$3,461.54 in uncompensated labor provided between January 25 and February 8, 1999, when applied to the January 25, 1999 \$10,000.00 preference, leave a balance of \$6,538.46 that may be avoided by the Trustee pursuant to § 547(b).

As the Defendant does not dispute the Plaintiff's entitlement to a judgment in the net amount of \$6,538.46, the parties will be directed to submit an appropriate judgment within ten days. The judgment will also provide for the payment of prejudgment interest from February 1, 2001, the date the Plaintiff filed her Complaint. *See Still v. Rossville Bank (In re Chattanooga Wholesale Antiques, Inc.)*, 930 F.2d 458, 465 (6<sup>th</sup> Cir. 1991); *DuVoisin v. Anderson (In re Southern Industrial Banking Corp.)*, 87 B.R. 518, 522 (Bankr. E.D. Tenn. 1988) ("Prejudgment interest in preference litigation accrues from the date of demand on the defendant, or absent demand, from the date the adversary proceeding is filed." (citations omitted)). The parties will be responsible for their own costs.

An order consistent with this Memorandum will be entered.

FILED: January 14, 2002

BY THE COURT

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE



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Debtor

ANN MOSTOLLER, TRUSTEE

Plaintiff

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EDWARD WILLIAMS

Defendant

**ORDER**

For the reasons stated in the Memorandum on Defendant's Motion for Summary Judgment filed this date, the court directs the following:

1. The Defendant's Motion for Summary Judgment filed November 30, 2001, is GRANTED. The net preferences the Plaintiff is entitled to avoid and recover total \$6,538.46, together with prejudgment interest from February 1, 2001.
2. As the Defendant does not dispute his obligation as fixed in paragraph one above, the parties will tender an appropriate judgment within ten (10) days.

SO ORDERED.

ENTER: January 14, 2002

BY THE COURT

RICHARD STAIR, JR.  
UNITED STATES BANKRUPTCY JUDGE